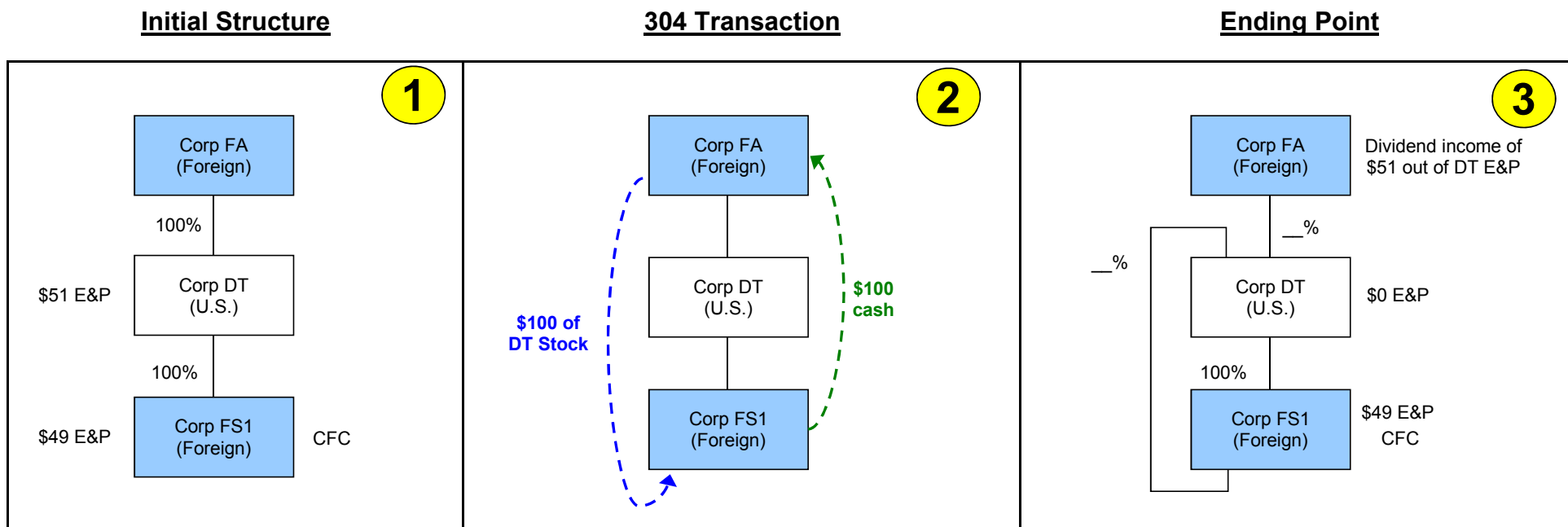


Code §304(a)(2) & (b)(5)(B): 50% Rule Only Applies to Earnings of Foreign Acquiring (Limit Applies)



FA, a foreign corporation that is not a CFC, wholly owns DT, a domestic corporation. DT wholly owns FS1, a CFC. DT has earnings and profits of \$51x, and FS1 has earnings and profits of \$49x. FA transfers DT stock with a value of \$100x to FS1 in exchange for \$100x of cash.

Under Code §304(a)(2), the \$100x of cash is treated as a distribution in redemption of the stock of DT. The redemption of the DT stock is treated as a distribution to which Code §301 applies pursuant to Code §302(d), which ordinarily would be sourced first from FS1 under Code §304(b)(2)(A). Without regard to the application of Code §304(b)(5)(B), more than 50% of the dividend arising from the acquisition, taking into account only the earnings and profits of FS1 pursuant to section 3.03(b) of Notice 2014-52, would not be subject to tax under Chapter 1 of the Code. In particular, no portion of a dividend from FS1 would be subject to U.S. tax or includible in the earnings and profits of a CFC.

Accordingly, Code §304(b)(5)(B) applies to the transaction, and no portion of the distribution of \$100x is treated under Code §301(c)(1) as a dividend (as defined in Code §316) out of the earnings and profits of FS1. Furthermore, the \$100x of cash is treated as a dividend to the extent of the earnings and profits of DT (\$51x).